No. 477

IN THE

Supreme Court of the United States,

OCTOBER TERM—1925.

F. S. ROYSTER GUANO COMPANY,
Plaintiff-Respondent,

—against—

AMERICAN RAILWAY EXPRESS COMPANY,
Defendant-Appellant.

BRIEF OF APPELLANT.

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Statement.

This is a review by certiorari of a judgment of the Special Court of Appeals of Virginia (the highest court of that state) affirming the judgment of the Circuit Court of the City of Norfolk in favor of F. S. Royster Guano Co., plaintiff-respondent, in an action brought against appellant, the American Railway Express Company.

This action is brought to hold the appellant liable for the amount of a judgment theretofore rendered against the Southern Express Company, appellant having acquired the property of the Southern Express Company theretofore used in its domestic express transportation business. The existence of the appellant and its exchange of its stock for the Southern Express Company's property arose from the action of the Executive branch of the United States Government during a state of war

in furtherance of the belief that complete unification of inland transportation was necessary to the successful prosecution of the war (R. 20).

On December 28, 1917, the President of the United States acting under the power conferred on him by vote of Congress, took possession and assumed control of practically all the railroad lines in the United States and appointed as his agent in charge thereof Wm. G. McAdoo, as Director General of Railroads.

The Southern Express Company and three other companies had been operating over these lines under long term contracts and immediately made application to the Director General of Railroads to ascertain whether they had been taken over with the railroad lines. The Director General finally held that he had not taken over the express companies and declared he would not do so. He indicated that he would be willing to deal with a single company which would operate all over the United States. The Southern Express Company preferred to operate for itself, or to have the company taken over under Federal control, but being confronted with such an emergency, and unable to continue its operations, transferred its property and $300,000 in cash to the American Railway Express Company in exchange for $1,750,000 par value of stock of that company (R. 22), but the transfer was only made in order to secure as nearly as possible the value of the physical property transferred (R. 21).

On July 1, 1918, the appellant began doing an express business in Virginia and elsewhere and the Southern Express Company withdrew from the State of Virginia and ceased doing business within that state (R. 33).

On September 15, 1919, the F. S. Royster Guano Company brought suit in the Circuit Court of the City of Norfolk against the Southern Express Company and the summons in such proceeding was served upon Hon. W. F. Rhea, Chairman of the Corporation Commission of Virginia (R. 34).

The Southern Express Company appeared specially and moved to quash on the ground that it was not carrying on its business in Virginia and had no agent in the State upon whom service could be made which motion was denied and later judgment was entered against the Southern Express Company by default which judgment lay dormant for about two years, no execution being taken out on same; but in July, 1922, the plaintiff in the before mentioned case filed a declaration in *assumpsit* against the appellant American Railway Express Company.

This declaration (R. 13) set forth that F. S. Royster Guano Company had recovered a judgment against the Southern Express Company which remained in full force and effect and unpaid; that prior to such judgment the American Railway Express Company took over from the Southern Express Company all the property theretofore belonging to it then owned and used by the Southern Express Company in its business throughout the United States, including all its property in Virginia, issuing therefor to the said Southern Express Company or to its stockholders stock of the American Railway Express Company by means whereof the assets of the said Southern Express Company have been distributed among its stockholders to the exclusion and prejudice of its creditors.

Upon the trial of the case the only affirmative evi-

dence introduced by the plaintiff was that the American Railway Express Company bought from the Southern Express Company all of the tangible property used by the Southern in its express business and paid for the same with capital stock at par (R. 17-23).

The evidence introduced by the plaintiff also showed that no agreement had been entered into at any time between the American Railway Express Company and the Southern Express Company by which it was to carry on an express transportation business theretofore transacted by the Southern; that the appellant did not take over the business of the Southern Express Company on the 1st of July or at any time (R. 22).

The appellant affirmatively showed by undisputed testimony that the Southern Express Company, exclusive of stock received from the appellant, retained real estate and treasury assets of approximately $1,000,000; that the Southern Express Company had not liquidated itself or distributed any of its property or stock of the American Railway Express Company to its stockholders; that there had been no distribution of any kind to the stockholders; that the stock of the American Railway Express Company received by the Southern was still in its possession; that no officer or director of the Southern Express Company was an officer of the appellant; that there was no voting trust or other agreement by which the Southern controlled the policy of the appellant, and that there was, or had been no contract between them under which the Southern agreed to reimburse the appellant; that the Southern Express Company still maintains its corporate existence with offices in New York at which it has officers who are authorized to accept service in suits against it; that

the Southern Express Company has ample assets to meet all remaining outstanding claims against it (R. 21-23).

Upon this record the Circuit Court of the City of Norfolk held the appellant liable for the judgment recovered by the plaintiff-respondent against the Southern Express Company and the Special Court of Appeals affirmed such judgment (R. 30).

The following grounds appear in the opinion of the Special Court of Appeals of Virginia for its decision:

> (1) That the validity of the judgment of the Circuit Court of the City of Norfolk rendered by default against the Southern Express Company, a foreign corporation which had withdrawn from the State of Virginia and upon which service of process had not been made, and to which action appellant was not a party, could not be questioned by appellant in an action to hold it liable on said judgment in any court of Virginia;
>
> (2) That the property of the Southern Express Company within the State of Virginia was impressed with a trust for the benefit of Virginia creditors;
>
> (3) That the American Railway Express Company was guilty of constructive fraud in the purchase of this property in exchange for its own stock and was not a *bona fide* holder for value so as to cut off rights of general creditors of the Southern Express Company to follow this property for the satisfaction of their claims.

The appellant's contention is that the decision of the State Court deprives it of its property without due pro-

cess of law and denies to it the equal protection of the law in that:

(1) It proceeds upon a principle of law based upon assumptions of fact which are unsupported by the record;

(2) It attempts to do by judicial decision what would be unconstitutional in a statute of similar effect;

(3) The decision is contrary to the established principles of common law and is an attempt at judicial legislation under the police power of the State which cannot be retroactively applied to affect vested rights;

(4) It deprives the appellant of its property without due process of law in that the alleged judgment upon which the instant case is based was null and void in that no service of process was made upon the Southern Express Company;

(5) It deprives the appellant of its property without due process of law in that it admits in evidence the record including the judgment, in a former adjudication and of which it had no notice, of a suit brought after the transfer of the property, to which the appellant was not a party.

POINT I.

The basis of fact upon which the Special Court of Appeals of Virginia rests its decision denying the asserted federal right has no support in the record.

There is no conflict in the testimony offered in this case. The action was brought against the appellant charging that the Southern Express Company had sold its property to the appellant for stock of the appellant issued to it or its stockholders and had distributed its assets among its stockholders to the exclusion and prejudice of its creditors. The proof showed that the stock of the appellant issued to the Southern Express Company was never distributed to its stockholders and that the Southern Express Company had distributed none of its assets to its stockholders in dividends or otherwise. Appellant bought from the Southern Express Company the physical property theretofore used by the Southern in its domestic express business in Virginia and elsewhere and paid for it in its own stock at par. The Court in its decision says:

> "It is uncontroverted that the Southern Express Company turned over its business and property used in its business, along with another express company, for its proportionate share of the stock of the defendant and ceased to do an express business, nor were any assets left in the State of Virginia to pay the obligations of the Southern Express Company."

The proof shows that the Southern Express Company did not sell its business nor did the appellant under-

take to carry on its business in Virginia or elsewhere, and it is clearly established that independent of the stock of appellant received by the Southern Express Company, it had approximately $1,000,000 in assets which were amply sufficient to meet all of its legal liabilities.

The Court held that the law in Virginia in reference to the merger of the Southern Express Company and others into the appellant as a consolidated company liable for the debts of the constituent companies had already been settled by the case of *American Railway Express Company* v. *Downing*, 132 Va. 139, and quotes the following from that case:

> "When two or more corporations are consolidated into a new corporation with a new name and the constituent corporations go out of existence, if no arrangements are made respecting their property and liabilities, the consolidated corporation will be answerable for their liabilities, at least to the extent of the property acquired from the constituent corporation whose liability is sought to be enforced against the consolidated corporation * * *.
>
> It is not essential to the liability of the corporation for the debts and claims against its constituent corporation that the constituent company cease to exist *de jure* upon the organziation of the new corporation. The going out of existence of the constituent company is the cessation of all actual transactions of business as a going concern; its continued existence *de jure* for the purpose of winding up its affairs is immaterial."

The Special Court of Appeals goes on to say:

> "The principles upon which the cases are based are that the assets of the constituent corporations are a trust fund for the payment of their debts, and when the consolidated corporation takes over the assets in exchange for stock and bonds, there is an implied contract in law to pay such debts out of the assets."

It is clear, therefore, from the opinion of the Court that its decision is fundamentally based upon facts which do not appear in the record here. The *Downing* case was one in which the appellant was sued upon a liability of the Adams Express Company, in the record of which no facts as to the relations of the appellant and the Southern Express Company appear, and in which case no federal question was raised. In order for the law applying to the instant case to be settled in Virginia by the *Downing* case, *supra*, it would be necessary for the record in the instant case to show: First, that the Southern Express Company sold its business as well as all of its property to and had merged into or consolidated with the appellant; second, that the Southern Express Company went out of existence, leaving no assets or insufficient assets to pay its debts.

The record in the instant case shows that the Southern Express Company was not merged in or consolidated with the appellant; that it still retains its independent corporate existence with ample assets to meet its liabilities; and has never made any distribution to its stockholders of any kind whatsoever. It seems clear, therefore, that the basis of the Virginia Court's decision has no support in the record.

The principles of law quoted but misapplied by the Virginia Court are of course well established by a long line of fairly uniform and consistent decisions constituting the so-called trust fund theory devised by the Courts to protect the creditors of a corporation against any distribution of assets to stockholders in fraud of creditors; and the principles underlying all of the cases is that where stockholders invest their money in a corporation's shares and substitute a limited liability as stockholders for the full liability of an individual, the capital stock of the corporation becomes a trust fund for the payment of creditors who must be satisfied *before a stockholder can withdraw* any portion of the capital so invested, and the assets so distributed may be followed into the hands of the shareholders or any person other than a *bona fide* purchaser for value.

This general impression, however, that the capital stock of the corporation becomes a trust fund applies *only* where a corporation is insolvent or is in process of dissolution. As said by Mr. Justice Brewer in *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371:

> "While it is true language has been frequently used to the effect that the assets of a corporation are a trust fund held by a corporation for the benefit of creditors, this has not been to convey the idea that there is a direct and express trust attached to the property. As said in 2 Pomeroy's Equity Jurisprudence, Section 1046, they 'are not in any true and complete sense trusts, and can only be called so by way of analogy or metaphor.'
>
> To the same effect are decisions of this court. * * * In other words, and that is the idea which underlies all these expressions in reference

to 'trust' in connection with the property of a corporation, the corporation is an entity, distinct from its stockholders as from its creditors. Solvent, it holds its property as an individual holds his, free from the touch of a creditor who has acquired no lien; free also from the touch of a stockholder who, though equitably interested in, has no legal right to, the property. Becoming insolvent, the equitable interest of the stockholders in the property, together with their conditional liability to the creditors, places the property in a condition of trust, first, for the creditor, and then for the stockholders. Whatever of trust there is arises from the peculiar and diverse equitable rights of the stockholders as against the corporation in its property and their conditional liability to its creditors. It is rather a trust in the administration of the assets after possession by a court of equity than a trust attaching to the property, as such, for the direct benefit of either creditor or stockholder." *Graham* v. *Railroad Co.*, 102 U. S. 148.

Wabash, St. Louis & Pacific Ry. Co. v. *Ham*, 114 U. S. 587;
Fogg v. *Blair*, 133 U. S. 534.

Again in the same decision, at page 385, the Court says:

"A party may deal with a corporation in respect to its property in the same manner as with an individual owner, and with no greater danger of being held to have received into his possession property burdened with a trust or lien. The officers of a corporation act in a fiduciary capacity

> in respect to its property in their hands, and may be called to an account for fraud or sometimes even mere mis-management in respect thereto; but as between itself and its creditors the corporation is simply a debtor, and does not hold its property in trust, or subject to a lien in their favor, in any other sense than does an individual debtor. That is certainly the general rule, and if there be any exceptions thereto they are not presented by any of the facts in this case."

This view has been followed generally. In *Pusey & Jones Co.*, 261 U. S. 491, it is said:

> "But an unsecured simple contract creditor has, in the absence of statute, no substantive right, legal or equitable, in or to the property of his debtor. The only substantive right of a simple contract creditor is to have his debt paid in due course. His adjective right is, ordinarily, at law. He has no right whatsoever in equity until he has exhausted his legal remedy. After execution upon a judgment recovered at law has been returned unsatisfied, he may proceed in equity by a creditors' bill."

In *Graham* v. *La Crosse and Milwaukee Railroad Co.*, 102 U. S. 148, it is said:

> "The contention that while an individual has supreme domination over his property, a corporation is a mere trustee, holding its property for the benefit of its stockholders and creditors, is not sound. * * * The corporation is a distinct entity entitled to hold property exactly as an individual can hold it."

In *McDonald* v. *Williams*, 174 U. S. 397, this Court said:

> "When a corporation is solvent the theory that its capital is a trust fund upon which there is any lien for the payment of its debts has in fact very little foundation. No general creditor has any lien upon the fund under such circumstances, and the right of the corporation to deal with its property is absolute so long as it does not violate its charter or the law applicable to such corporation."

There are many instances of fraudulent conveyances in which the trust fund doctrine has been referred to as the basis for permitting a creditor to follow property conveyed without consideration in fraud or creditors. As this Court said in *Wabash, St. Louis & Pacific R. R. Co.* v. *Ham*, 114 U. S. 587:

> "The property of a corporation is doubtless a trust fund for the payment of its debts in the sense that when the corporation is lawfully dissolved and all its business wound up, or when it is insolvent, all its creditors are entitled in equity to have their debts paid out of the corporate property before any distribution thereof among the stockholders. It is also true, in the case of a corporation, as in that of a natural person, that any conveyance of property of the debtor, without authority of law, and in fraud of existing creditors, is void."

Under these well established principles of law, for the Virginia Court to hold the appellant liable for debts or liabilities of the Southern Express Company it would be necessary for the record to show (1) that there was

an actual consolidation or merger under which the Southern Express Company became extinguished and the appellant either expressly or by necessary implication of law undertook to pay its debts or liabilities; or, (2) that the Southern Express Company was insolvent and that the transfer of the property to the appellant was a fraudulent conveyance without consideration to defeat the creditors of the Southern Express Company.

The record clearly shows that there was no actual merger or consolidation of the Southern Express Company with the appellant under the usual tests, either by purchase of the stock of the Southern or by purchase of all or substantially all of its property by which the Southern went out of existence and the shareholders became shareholders of the appellant, or that the Southern Express Company at the time of the sale was insolvent. None of these facts appears in the record. Upon the contrary it is clearly shown that the appellant bought a certain part of the property of the Southern and paid for it in its own stock, the property remaining in the Southern's corporate possession being ample to pay all of its liabilities, and none of the property of the Southern being distributed to its shareholders. As to actual fraud, this would seem impossible from the record, nor do we understand that any such charge is made. The Director General of Railways acting under the authority of the President of the United States conceived that it was necessary to unify the express service of the country as the railroads had already been unified to meet the needs of the nation in time of war. He could not permit the unified railroads to be hampered by the several express companies in such an emergency and he required all of

them to cease their operations over the railroads controlled by him and practically constrained them to sell such of their property as was necessary to his purpose to the appellant and a corporation formed under his supervision.

The payment for the property was in stock according to his requirements. He refused to pay cash. If, therefore, actual fraud be charged on this record, it must be the fraud of the Director General since all of the terms of the sale were not only suggested but practically enforced by him. It is, of course, apparent that the Director General could not possibly have benefitted from any actual fraud and, since the appellant and the Southern Express Company both acted under his constraint in the entire transaction, it would seem that actual fraud cannot be deduced from anything in the record.

As to constructive fraud, it would seem necessary, in order to support such a charge, that there must be some circumstances in the case to indicate that the appellant has in its possession assets of the Southern Express Company which it cannot, in equity and good conscience, retain; and these assets must be subject to an equitable claim of the plaintiff and creditors of the Southern Express Company; or, in other words, it must appear that the appellant is not a *bona fide* purchaser for value if the Virginia Courts be held to be right in their judgment. It very clearly appears in the instant case that the Southern Express Company did not by the sale of its property to the appellant place itself in a position to prejudice the interests of its creditors or to substantially impair their remedy against it, since

the Southern Express Company as a corporate entity after the transaction was completed, was in as good, if not a better, position financially to meet its liabilities than it would have been had it refused to sell its property to the appellant: because, as clearly appears from the evidence, it would have been left with its property scattered throughout a number of states in small quantities which could not have been readily disposed of except to someone engaged in the same line of business and, as also shown by the record, it was impossible for any one to engage in the express business at this time without the consent and approval of the Director General who controlled all of the railroad facilities necessary to that business. The Southern Express Company by its acceptance of the Director General's decision sold its property for its approximate cash value and received therefor stock of the appellant which certainly must have represented a greater value in the aggregate than the scattered items of property usable only in the express business had the Southern undertaken to sell its property to others. It cannot, therefore, be said upon the record that the sale of this property to the appellant in any way impaired the rights of creditors of the Southern Express Company.

It would seem that the Virginia Court in the instant case has been misled primarily by the fact that the appellant paid for the property purchased with its own stock instead of cash, and it may readily be that this error has arisen primarily from the fact that in practically all of the cases in which one corporation has been held liable for the debts of another under the trust fund theory, there has been no real change of ownership, but merely a change in the *form* of ownership, the pur-

chasing company paying for the assets of the extinct corporation in its stock which was distributed to the stockholders of the extinct corporation in place of their stock in the extinct company, so that the stockholders of the old corporation became stockholders of the new corporation, and there was no *bona fide* purchase or sale of assets, but simply a change in the name, under the control of the same parties in the new corporation who were in control of the old corporation.

It may be said that the authorities quoted by the Virginia Court rest upon just such cases where the transfer of property was not a *bona fide* sale, and really not any change of ownership, but merely a change in form designed to defeat and defraud creditors, and this has been rightly recognized by the Courts as fraud. It does not, however, as apparently assumed by the Virginia Court, necessarily follow that in every transaction in which stock of the purchasing corporation is issued in payment for the property of the debtor corporation, the transaction is not a *bona fide* purchase and sale or that the rights of the creditors are prejudiced by the transaction.

We submit, in all confidence, that in none of these cases will be found authority for the proposition that the purchasing corporation may be held liable for the debts and liabilities of the debtor corporation where the transaction entered into left the creditors of the debtor corporation in a position to enforce against it the payment of its liabilities and where there were ample assets in its hands to meet such liabilities.

It is true that where stock given for the property has been distributed to the stockholders of the debtor cor-

poration, and no other assets were found to meet its liabilities, the Courts have held that creditors were not obliged to pursue their remedy against the individual stockholders, but might follow the property. But this comes back to the proposition that in every such case there was no *bona fide* sale or purchase but a fraudulent transfer to distribute corporate assets among shareholders in fraud of creditors.

It clearly appears in the instant case that payment in stock, instead of cash, for the property bought by appellant did not in any way affect the rights or even the convenience of Virginia creditors.

Neither the buyer nor the seller was a Virginia corporation and the contract was made in New York. If the appellant paid for the property bought in cash, there would have been no more assets in Virginia for the convenience of Virginia creditors than there were under the actual conditions of the sale, since the Southern Express Company, having withdrawn its business from Virginia would hardly be expected to send the cash realized to that state for deposit, to its own inconvenience.

The Virginia Court, therefor, did not have before it in the record, nor were there in existence, the facts necessary to support its decision, and it is the duty of this Court to review and correct the error.

Postal Tel. Cable Co. v. *Newport*, 247 U. S. 473;
So. Pacific v. *Schuyler*, 227 U. S. 611;
N. C. Ry. Co. v. *Zachary*, 232 U. S. 248;
Carlson v. *Curtis*, 234 U. S. 103;
Norfolk & W. R. Co. v. *Conley*, 236 U. S. 605;
Interstate A. Co. v. *Albert*, 239 U. S. 560.

POINT II.

The Special Court of Appeals of Virginia attempts to establish by judicial decision a rule of law which would be unconstitutional if created by statute; but, even if the State Legislature could properly enact such a statute, the decision of the State Court is not based upon principles of common law but is an attempt at judicial legislation under the police power of the State which cannot be applied retroactively to affect vested rights.

It is difficult to determine from the decision of the Special Court of Appeals of Virginia the exact ground upon which its decision is based. The authorities quoted by the Court for its decision deal with consolidated corporations only; while in the instant case the record is clear and positive that there was no consolidation, nor any expressed or implied agreement to assume the debts and liabilities of the selling corporation. It would seem that the Court of Appeals of Virginia assumes that in every case where property is purchased and paid for in stock of the purchasing corporation this *ipso facto* effects a consolidation or merger to such an extent as to make the purchasing corporation liable for the debts of the selling corporation, even though the selling corporation makes no distribution of the stock received for the property and has ample assets independent of such stock to meet the claims of its creditors.

One thing clearly appears from the decision of the Court and its citations of authorities which may be summed up in brief as follows: that the property located

in Virginia of a solvent foreign corporation constitutes a trust fund for the benefit of Virginia creditors.

There is neither constitutional nor statutory provision in Virginia imposing upon a person or corporation buying all or a part of the property of a foreign corporation doing business in Virginia liability for the debts of the selling corporation, even though the purchase price may be paid in stock of the purchasing corporation. The Legislature of the State of Virginia in the exercise of the police power of the State might enact a statute for the protection of its own citizens as creditors of a foreign corporation coming into the State to do business, provided such enactments were reasonably necessary for the object to be attained and did not invade rights under the Federal Constitution. It seems clear, however, under the decision of this Court in *Blake* v. *McClung*, 172 U. S. 239, that the State of Virginia could not without violating rights safe-guarded under the Constitution of the United States, even by statute, subject the assets of a foreign corporation doing business within the state to the claims of creditors within the state in preference to the right in equity of citizens residing in other states to participate upon terms equivalent with the citizens of Virginia in the distribution of assets of an insolvent corporation; and, from the decision in that case, it would seem even more doubtful that the Legislature of Virginia could impose the harsh and unreasonable rule that the property of any foreign corporation coming into Virginia to do business must be impressed with a trust in favor of Virginia creditors, although the corporation itself was solvent and, being engaged in interstate commerce, could

not be excluded from doing business within the State. As said by the Court in *Blake* v. *McClung, supra*:

> "We hold such discrimination against citizens of other states to be repugnant to the second section of the fourth article of the Constitution of the United States, although, generally speaking, the state has the power to prescribe the conditions upon which foreign corporations may enter its territory for the purpose of business. Such a power cannot be exercised with the effect of defeating or impairing rights secured to citizens of the several states by the supreme law of the land."

The appellant in the instant case, a corporation engaged in interstate commerce, cannot be excluded from the State of Virginia by any statute of the Legislature, nor can the State require from it in advance any agreement expressed or implied as a condition of doing business. *Crutcher* v. *Kentucky*, 141 U. S. 474.

It seems doubtful, therefore, if the State of Virginia could, without a regulation of interstate commerce obnoxious to the Federal Constitution impose upon the appellant any burdens with respect to the use of its property within the State of Virginia, even by statutes passed for future operations.

Any doubt in the matter, however, disappears when we come to the question of the power of the Legislature to pass a statute affecting vested rights and acting upon transfers of property acquired prior to such legislation.

There can be no question that a statute creating a lien or obligation upon property already acquired before the enactment of the statute to pay the debts or lia-

bilities of the vendor in a sale consummated four years previous would be invalid, not only as impairing the obligation of a contract, but also as a deprivation of property without due process of law.

The Special Court of Appeals of Virginia, however, in the instant case undertakes to do by judicial decision what would be clearly unconstitutional if enacted as a statute by the Legislature of Virginia. The transaction entered into, by which the property was purchased by the appellant, was completed on July 1, 1918, and there was not prior to that date any decision by the state courts of Virginia imposing on the appellant a liability which did not attach by common law. So far as the decisions of the State of Virginia and the ruling decisions of other states and of this Court are concerned, the appellant took the property of the Southern Express Company free and clear of any lien of creditors and paid for the same upon the basis of its securities issued under the approval of an officer of the United States Government. There was no fraud, actual or constructive, and no suspicion of fraud attending the transaction which, by reason of its importance, received the widest publicity. Long after the appellant had closed up all of its transactions with the Southern Express Company and paid over to it all amounts due the Southern which came into its hands through the closing up of unfinished contracts, arises this claim on behalf of plaintiff who for two years held his judgment against the Southern Express Company without taking out an execution on the same or apparently endeavoring to collect it in any state in which the Southern Express Company had property.

The highest court of Virginia upon the record already pointed out, holds the appellant liable for the debts and liabilities of the Southern Express Company in Virginia; and, in so doing, enacts a new rule of law which would be unconstitutional if applied by statute. As said by this Court in *Blake* v. *McClung, supra*:

> "It is an established rule of equity that when a corporation becomes insolvent it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors (*Graham* v. *Railroad Co.*, 102 U. S. 148, 161)—*not simply of stockholders and creditors residing in a particular state, but all stockholders and creditors of whatever state they may be citizens.* (Italics ours.) In *Wabash, St. Louis, etc. Railway Co.* v. *Ham*, 114 U. S. 587, 594, it was said that the property of a corporation was a trust fund for the payment of its debts, in the sense that when the corporation was lawfully dissolved and all its business wound up, or when it was insolvent, all its creditors were entitled in equity to have their debts paid out of the corporate property before any distribution thereof among the stockholders. In *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371, 385, it was observed that a private corporation, when it becomes insolvent, holds its assets subject to somewhat the same kind of equitable lien and trust in favor of its creditors that exists in favor of the creditors of a partnership after becoming insolvent, and that in such a case a lien and trust will be enforced by a court of equity in favor of creditors. These principles obtain, no doubt, in Tennessee, and will be applied by its courts in

> all appropriate cases between citizens of that State, without making any distinction *between them*. Yet the courts of that State are forbidden, by the statute in question, to recognize the right in equity of citizens residing in other States to participate upon terms of equality with citizens of Tennessee in the distribution of the assets of an insolvent corporation lawfully doing business in that State."

If the rule announced by the Virginia Court of Appeals would have been unconstitutional as a statute, it seems clear that this Court can review it if its effect is to deny appellant the equal protection of the law and deprive it of property without due process of law.

Prudential Insurance Co. v. Cheek, 259 U. S. 529:

> "It seems to us clear that the state might, without conflict with the 14th Amendment, enact through its legislative department a statute precisely to the same effect as the rule of law and public policy declared by its court of last resort. And, for the purposes of our jurisdiction, it makes no difference, under that Amendment, through what department the state has acted. The decision is as valid as a statute would be."

The amendment of February 17, 1922, to Section 237 of the Judicial Code, clearly indicates that a change in a rule of law established in a state by judicial decision may violate rights under the Federal Constitution:

> "In any suit involving validity of a contract wherein it is claimed that a change in the rule of law or construction of statutes by the highest

> court of a state would be repugnant to the Constitution of the United States, the Supreme Court shall upon writ of error remand, reverse or affirm the judgment of the State Court if such claim is set up in the case before the final judgment is entered by the State Court and the decision is against the claim so made."

This amendment clearly recognizes that rights may be vested under a rule of law laid down by the highest court of the state and that a change in such rule of law made by the highest court of the state may be repugnant to the Federal Constitution as impairing these vested rights. While this case does not come before this Court upon a writ of error, the question of the validity of a contract, *i. e.*, the contract of purchase by the appellant and sale by the Southern Express Company of its property is involved and is subject to review by this Court upon a writ of certiorari.

The decision of the State Court below, not being based upon any statutes or constitutional provision of the State of Virginia presumably depends for support upon the principles of the common law. There is, however, in the present case no peculiar reason for this Court to defer to the decision of the Virginia Court as to common law. It is the duty of Federal Courts to determine for themselves questions of commercial law, general jurisprudence and of rights under the Constitution of the United States.

Oates v. *First National Bank*, 100 U. S. 246;
Swift v. *Tyson*, 16 Peters. 1;
Guernsey v. *Imperial Bank*, 188 Fed. 300;
First National Bank v. *Liewer*, 187 Fed. 16.

Even if the decision of the Virginia Court were to be held to have created a fixed rule of property in the State of Virginia, the decision was made after the rights of the parties had accrued and was not controlling on the Federal Courts. It is their duty to exercise their independent judgment as to what the common law is.

> *Great Southern Fireproof Hotel Co.* v. *Jones*, 193 U. S. 532;
>
> *Shaw* v. *C. C. C. & St. L. R. Co.*, 173 Fed. 750;
>
> *Brewer-Elliott Oil & Gas Co.* v. *U. S.*, 270 Fed. 104.

To make the decisions of the State Court obligatory on the Federal Court, the right must have accrued after the rule had been established.

> *Murray* v. *Wilson Distilling Co.*, 213 U. S. 157;
>
> *Great Southern Fireproof Hotel Co.* v. *Jones*, *supra*.

The rule previously established in Virginia as in other states where a corporation transferred all of its property to another corporation in exchange for stock of the new corporation and, after such transfer, the new corporation was controlled by the persons who had controlled the old corporation or the stock received or distributed among the stockholders of the old corporation, was that the new corporation was liable for the debts of the old, at least to the extent of the property acquired. However, the rule established in the present case extends the imposition of liability to an extent never

dreamed of previously. In this case, the vendor was a solvent corporation, the property transferred in Virginia was a very small part of the entire property and the selling corporation retained more than $1,000,000 in solid assets, amply sufficient to pay all of its debts and liabilities. There was no identity of control between the two corporations and the total stock received in Virginia and elsewhere by the selling corporation was approximately only about 5% of the stock of the purchasing corporation. There was no dissolution of the corporation and no distribution of stock to its stockholders of any kind. The old rule was applied because of identity of control, or the fact of dissolution of the old corporation or the distribution of the proceeds. The new rule holds that it is immaterial whether or not there is identity of control or the vendor remains in business or whether or not the proceeds of the sale are distributed among shareholders of the vendor. The only material thing, in view of the new rule, is that it is stock of the new corporation which is issued in exchange for the property transferred. The general rule of the common law is that a corporation which purchased all the property of another corporation is not *ipso facto* liable for the debts of the latter.

Postal Telegraph Co. v. *Newport*, 247 U. S. 464;

Gray v. *National Steamship Co.*, 115 U. S. 116;

Fogg v. *Blair*, 133 U. S. 534;

Koch v. *Speedwell*, 140 Pac. 598 (Cal.);

Buckler v. *U. S., etc. Co.*, 112 Atlantic 632 (Pa.);

Hageman v. *Southern Ry. Co.*, 202 Mo. 249;
McAlister v. *American Ry. Ex. Co.*, 103 S. E. 129 (N. C.);
Swing v. *Empire Lumber Co.*, 105 Minn. 356;
Cook on Corporations, 8th Edition, Vol. 3, Sec. 673, and cases cited.

The decision of the Virginia Court was not necessary to preserve the rights of creditors of the Southern Express Company who had exhausted every other remedy in an effort to collect, *but was imposed merely for the convenience of Virginia creditors.* The only right which was lost to the Virginia creditors by the transfer was that of having their claims adjudicated by Virginia courts, but the presumption of course attaches that a Virginia court would deal as fairly and impartially with a controversy arising between its own citizens and a foreign corporation as the Courts of another state. Hence the right so lost could not, without discourtesy to the Virginia Courts, be termed an advantage, but merely a convenience.

So far as the absolute rights of creditors are concerned in the instant case, they would not be impaired to any greater extent had the appellant bought the property of the Southern Express Company for cash and paid over the amount where the transaction of sale of all the property was completed, *i. e.*, at New York. They might have regarded it as inconvenient to bring their suits in New York where the property of the Southern Express Company was located, but if the convenience of litigants is to be made the determining factor, then it might be argued with equal force that if a corporation sold its property in a single county or municipality in

any state, the purchaser would take the property subject to an implied obligation to meet the debts and liabilities of the selling corporation arising within that particular county or municipality. In the instant case, however, the Court has not even the justification of convenience. No creditor in Virginia or elsewhere of the Southern Express Company was prejudiced by the transfer of the property to the appellant, and the Southern Express Company was in a better position to respond to the demand of its creditors than it was before the sale. The contract between the appellant and the Southern Express Company for the purchase of its property was valid under the common law of Virginia and elsewhere at the time it was made and nothing in the conduct of the appellant has in any way contributed to change it. The appellant became the owner of the property free and clear of all liens in July, 1918. The effect of the rule created by the Virginia Court is to make a new contract between the American Railway Express Company and the Southern Express Company under which the appellant is required to pay in addition to the consideration of the original contract the indefinite and indefinable sum of any claim of Virginia creditors which may be brought against it. As already pointed out an enactment by statute of the Virginia Legislature to the effect of this decision would be clearly unconstitutional, and it is impossible for us to see any distinction between judicial legislation by the Court under the police power and the enactment by the State Legislature under the same power. The law of the land established the ownership of the property in the appellant. The rule established by the Virginia Court takes it away four years after

the property was acquired. If this be not lack of due process of law and deprivation of the equal protection of the law, it is difficult to imagine a situation to which these terms would be applicable.

POINT III.

The judgment of the Circuit Court of the City of Norfolk against the Southern Express Company on which the judgment in this case is based is null and void because the Court did not have jurisdiction of the Southern Express Company and hence to require the appellant to satisfy a judgment based upon such claim would be to deprive it of its property without due process of law.

The appellant is held by the Virginia courts for an alleged liability of the Southern Express Company upon the theory that a purchase of a part of the property of the Southern Express Company rendered appellant liable for its debts and liabilities in Virginia.

The basis of the action against the appellant is a judgment entered by default in May, 1920, against the Southern Express Company, a foreign corporation, which admittedly withdrew from the State of Virginia on July 1, 1918, and has never been in business in the state since that time. The suit on which this judgment was entered was brought in September, 1919, and by order of the Court summons was served on the Chairman of the Corporation Commission of Virginia. The record shows that the Southern Express Company had no agent authorized to accept service within the state and that it appeared specially and moved to quash upon the

ground that it was not doing business within the state and that no proper service had been made upon it. The appellant was not a party to this action and it will be seen that the suit was brought more than a year and judgment rendered more than two years *after the purchase by the appellant of part of the Southern Express Company's property.* The judgment in question remained dormant for more than two years, no execution being taken out on same, and in July, 1922, this action was brought against the appellant, the declaration reciting the judgment recovered against the Southern Express Company, the purchase of all of the property of the Southern Express Company in Virginia by the appellant and *the distribution of the assets of the Southern Express Company among its stockholders to the exclusion and prejudice of its creditors.*

(a) *The judgment against the Southern Express Company is null and void.*

As already pointed out, the Southern Express Company, a foreign transportation corporation, doing business within Virginia up to June 30, 1918, withdrew from the state and left in it no authorized agent for the service of process. An attempt, therefore, of the Virginia courts to give effect to process served upon one of the state officials conferred no jurisdiction upon the court to enter a judgment *in personam* against the Southern Express Company. As said by this Court in *Philadelphia & Reading Co.* v. *McKibbin*, 243 U. S. 264:

> "A foreign corporation is amenable to process to enforce a personal liability in the absence of consent only if it is doing business within the

> state in such a manner and to such an extent as to warrant the inference that it is present there, and even if it is doing business within the state, the process will be valid only if served upon some authorized agent. *St Louis S. W. Ry.* v. *Alexander*, 227 U. S. 226. Whether the corporation was doing business within the state and whether the person served was an authorized agent are questions vital to the jurisdiction of this court. A decision of the lower court if duly challenged is subject to review in this court, and the review extends through findings of fact as well as conclusions of law."

The evidence in the case is without conflict. It is conceded by stipulation that the Southern Express Company was not doing business in the state after July 1, 1918. The return of the sheriff in the suit shows that no authorized agent of the company was served. Under the decisions of this Court, therefore, the judgment of the Circuit Court of the City of Norfolk was null and void, because the Southern Express Company did not have its day in court.

The Special Court of Appeals of Virginia apparently holds that the judgment against the Southern Express Company was merely voidable and not absolutely void, saying:

> "The Circuit Court of the City of Norfolk, a court of general jurisdiction, having jurisdiction of the subject matter and the parties upon the service of process adjudged by it to be valid and not void upon its face, is conclusive in Virginia upon other courts and not open to collateral attack. * * * The Southern Express Com-

> pany has not been denied due process of law and the judgment against it was properly admitted in evidence."

The Virginia courts appear to have been misled by failing to observe the distinction between void judgments and those which are merely voidable, and in this error not only are out of harmony with the uniform decisions of this Court and other states, but also with the decisions of their own courts. In *Gray* v. *Stevart*, 74 Virginia 351, the Court said:

> "The leading distinction is between judgments and decrees merely void and such as are voidable only. The former are binding nowhere; the latter everywhere until reversed by a superior authority." (Citing *Harris* v. *Hartman*, 14 How. 334.)

As said by this Court in an opinion by Mr. Justice White in *Haddock* v. *Haddock*, 201 U. S. 562:

> "Where a personal judgment has been rendered in the courts of a state against a non-resident merely upon constructive service and, therefore, without acquiring jurisdiction over the person of the defendant, such judgment may not be enforced in another state in virtue of the full faith and credit clause. *Indeed a personal judgment so rendered is by operation of the due process clause of the Fourteenth Amendment void as against the non-resident, even in the state where rendered, and, therefore, such non-resident in virtue of rights granted by the Constitution of the United States may successfully resist even in the state where rendered, the enforcement of such a judgment.*" (Italics ours.)

Again, as said in *McDonald* v. *Maybee*, 243 U. S. 90:

> "An ordinary personal judgment for money, invalid for want of service amounting to due process of law, is as ineffective in the state as outside of it."

The finding of the Circuit Court of the City of Norfolk that it had jurisdiction of the case could not confer jurisdiction on the Court unless it affirmatively appeared in the record that the defendant Southern Express Company, a foreign corporation, was doing business within the State. *Knapp* v. *Wallace*, 50 Oregon 348.

The record in the instant case abundantly shows that the Southern Express Company was not within the jurisdiction of the Court. The declaration, while reciting that the Southern Express Company is a foreign corporation authorized to do business in Virginia, does not recite that the Southern Express Company was doing business in Virginia at the time the action was brought. The return of the sheriff recited that the lawfully appointed agent of the company for the service of legal process was no longer a resident of Virginia and was absent from the state and that no person residing in the state had been appointed in his place and that the summons was executed by delivering a copy to the Chairman of the State Corporation Commission.

The record of a special appearance and motion to quash on behalf of the Southern Express Company recites that at the time of and before the service of process it had no agent in the state on whom the said notice could be lawfully served and at the time of the aforesaid attempted service it was not carrying on its business in

Virginia and did not accept or waive service of said writ.

In the instant case, counsel for the plaintiff stipulated that after July 1, 1918, the Southern Express Company no longer operated a transportation company in Virginia. It clearly appears, therefore, that the Circuit Court of the City of Norfolk, in adjudging that it had jurisdiction of the Southern Express Company in an action *in personam* relied solely upon the jurisdiction obtained by service on the Chairman of the Corporation Commission, presumably under the Virginia statute affecting transportation corporations who have failed to designate an agent for service of process. But the statute in question must be construed as affecting only such corporations as are still doing business within the state since to give it a construction that would enable service to be made upon corporations not doing business within the state would be to extend the laws of Virginia beyond its borders. As said by this Court in *St. Clair v. Cox*, 106 U. S. 350, construing a similar state law:

> "We do not understand the law as authorizing the service of a copy of the writ as a summons upon an agent of a foreign corporation, unless the corporation be engaged in business in the state and the agent appointed to act there. We so construe the words 'agent of such corporation within the state.'"

Again, at page 359 in the same case, the Court says:

> "It is sufficient to observe that we are of the opinion that when service is made within the

> state upon an agent of a foreign corporation, it is essential in order for the jurisdiction of the court to render a personal judgment it should appear somewhere in the record, either in the application for the writ or accompanying its service or in the pleadings or the findings of the court that the corporation was engaged in business in the state."

It seems clear, therefore, that under the decisions of this Court, the statute of Virginia prescribing substituted service upon the Chairman of the Corporation Commission must be held to apply only to those foreign corporations which are doing business within the state at the time of the attempted service; and that any construction by the courts of Virginia that the statute contemplated service upon the Chairman of the Corporation Commission in the case of a foreign corporation not doing business within the state would make the statute itself obnoxious to the Federal Constitution as lacking in due process of law. Therefore, the judgment of the Circuit Court of the City of Norfolk against the Southern Express Company is void because it clearly appears the Court did not have jurisdiction to enter a judgment *in personam* against that company.

(b) *For the Virginia courts to require the appellant to satisfy a judgment based upon a nullity would be to deprive the petitioner of its property without due process of law.*

Even if appellant had specifically assumed the debts and liabilities of the Southern Express Company a judgment against appellant upon a liability of the

Southern Express Company could only be rendered after a hearing following due process of law and proof of fact establishing such liability. If appellant were in fact or in law liable for the liabilities of the Southern Express Company, the law of the land requires that such liabilities be established by proof of facts in an action in which appellant is a party or in which it might plead and prove any defenses which could be pleaded or proved by the Southern Express Company. Under such conditions the appellant might become liable for a judgment against the Southern Express Company secured *prior* to the purchase of the property and of which the appellant therefore would be deemed to have had notice when it purchased the property as a possible lien against the same, or if the appellant had been made a party to the action against the Southern Express Company, and thus have had notice of the liability claimed against it, and the opportunity to defend in the action upon which the void judgment was rendered. The appellant was in Virginia doing business throughout the state and easily accessible for service upon it in such suit while the Southern Express Company was beyond the jurisdiction of the Virginia courts. Notwithstanding these facts more than four years elapsed before the appellant in the suit in the instant case was served with any notice that the creditors of the Southern Express Company asserted a lien on the property purchased from that company by the appellant. Indulging the respondent to the greatest extent possible, therefore, it would seem that neither in law nor in equity could it assert successfully a claim against appellant under such a state of facts.

The judgment of the Circuit Court of the City of

Norfolk against the Southern Express Company being a nullity it necessarily follows that a judgment against the appellant based upon a void judgment must also be a nullity and a denial of due process of law. The appellant under the law of the land is entitled to notice and a full hearing and to have judgment rendered against it only upon the proof of facts which rendered it liable. The admission, therefore, by the Circuit Court of the City of Norfolk of the record and judgment in a prior adjudication to which the appellant was not a party and of which it can neither be charged with constructive notice or actual notice was a denial of due process of law within the meaning of the federal constitution.

But the record in the instant case shows clearly that the appellant was not liable for the debts of the Southern Express Company and that the conditions attending the purchase by it of the property of the Southern Express Company did not impress that property with a lien or trust in favor of creditors. The Southern Express Company was not insolvent. Upon the contrary, it had ample property for the satisfaction of every legal liability against it. As said in *McDonald* v. *Williams*, 174 U. S. 397:

> "When a corporation is solvent, the theory that its capital is a trust fund upon which there is any lien for the payment of its debts has in fact very little foundation. No general creditor has any lien upon the fund under such circumstances, and the right of the corporation to deal with its property is absolute so long as it does not violate its charter or the law applicable to such corporation."

The appellant was a *bona fide* purchaser for value under circumstances which exclude any suggestion of fraud either actual or constructive, and was entitled to purchase the property it obtained from the Southern Express Company without regard to the latter's creditors. As said in *Hollins* v. *Briarfield Coal & Iron Co.*, 150 U. S. 371:

> "A party may deal with a corporation in respect to its property in the same manner as with an individual owner and with no greater danger of being held to have received into his possession property burdened with a trust or lien."

The judgment against the Southern Express Company being *in personam* and the Court having no jurisdiction of the defendant, the entire proceeding was a nullity, and therefore to take the property of the appellant to satisfy a void judgment against the Southern Express Company is lacking in due process of law under the Federal Constitution.

POINT IV.

The judgment of the Special Court of Appeals of Virginia should be reversed and bill of the plaintiff-respondent should be dismissed.

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